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No. 304

# In the Supreme Court of the United States

OCTOBER TERM, 1958

JOSIAH E. DU BOIS, JR., TRUSTEE OF CHERRY VALLEY HOMES, INC., PETITIONER,

*v.*

UNITED STATES OF AMERICA

*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT*

## BRIEF FOR THE UNITED STATES IN OPPOSITION

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### OPINIONS BELOW

The District Court wrote no opinion. The opinion of the Court of Appeals (Pet. 35-37) is reported at 255 F. 2d 706.

### JURISDICTION

The judgment of the Court of Appeals was entered on June 2, 1958. (Pet. 38.) The petition for a writ of certiorari was filed on August 25, 1958. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254.

### QUESTIONS PRESENTED

1. Whether a levy made upon a taxpayer's debtor under Section 6332 of the Internal Revenue Code of 1954, prior to insolvency, is effective to appropriate the debt to the United States and thereby establish a

priority of right in the Government to satisfaction which is unaffected by the debtor's subsequent insolvency.

2. Alternatively, whether the levy at least accomplished an assignment of taxpayer's claim against the debtor to the United States, by operation of law, whereby the obligation became, as of the date of the levy, a debt "due to the United States" within the meaning of Revised Statutes, Section 3466, entitling the United States to priority of payment.

## STATUTES INVOLVED

Sections 6331 and 6332 of the Internal Revenue Code of 1954, and Revised Statutes, Section 3466, are set forth in Appendix, *infra*, pp. 10-12.

## STATEMENT

The facts as they appear in the certificate of review filed by the Referee (Pet. 20-29) are as follows:

The debtor, Cherry Valley Homes, Inc., is one of several closely affiliated corporations engaged in the construction of residential dwellings and the development of real estate. On May 28, 1957, it filed a voluntary petition for reorganization under Chapter X of the Bankruptcy Act. Three of the affiliates—namely, Anchorage Construction Company, Cherry Valley Builders, Inc., and Delaware Valley Builders, Inc.—were mere straw corporations working for the benefit of the debtor, and their debts are the debts of the corporation in reorganization. Prior to the inception of the reorganization proceedings, these three affiliates were indebted to the taxpayer, M. Tobin Company, Inc., in the total amount of $7,473.50 as follows: Anchorage Construction Company, $1,139; Cherry Valley Builders,

Inc., $3,720.50; and Delaware Valley Builders, Inc., $2,614.

The M. Tobin Company, Inc., is indebted to the United States for various tax claims (unpaid withholding and employment taxes for the first and second quarters of 1956) in a sum in excess of $8,000. No part of those taxes has been paid. On December 3, 1956, the District Director of Internal Revenue for Philadelphia levied upon the three affiliates demanding payment of any sums they owed the taxpayer as partial satisfaction of the tax liability. Nothing having been paid pursuant to those levies, the District Director, on or about August 30, 1957, filed proof of claim for those taxes in the reorganization proceeding and demanded priority of payment thereof. The claim was addressed against the debtor corporation and its three affiliates.

The Referee refused to allow the priority of this claim and ruled that the United States would be limited to the amount which the taxpayer would be entitled to as an unsecured general creditor. The District Court sustained the decision of the Referee, but the Court of Appeals unanimously reversed the judgment of the District Court.

## ARGUMENT

The court below held that (Pet. 36), "[i]n legal contemplation and consequence", the levy effected by the District Director of Internal Revenue upon the taxpayer's debtor, Cherry Valley Homes, Inc., six months prior to the time the debtor filed a voluntary petition for reorganization under Chapter X of the Bankruptcy Act, "effectively and exclusively appropriated the debt to the satisfaction of the tax claim" of the United States, and was clearly sufficient to establish a priority

of right to satisfaction which the debtor's subsequent insolvency did not effect. Alternatively, the court held (Pet. 36-37) that, in any event, the tax levy at least accomplished an assignment of the taxpayer's claim against the debtor to the United States by operation of law, and that this approach brought into decisive effect Section 3466 of the Revised Statutes (Appendix, *infra*, pp. 11-12), which provides that "whenever any person indebted to the United States is insolvent * * * the debts due to the United States shall be first satisfied."

Both of these alternative holdings are correct, and the correctness of either would require that the judgment below be sustained. In addition, there is no conflict of decisions, nor any other reason warranting review by this Court.

1. The court's primary holding—that the levy appropriated the debt to the satisfaction of the tax claim—finds support in *United States* v. *Eiland*, 223 F. 2d 118 (C.A. 4th), which is directly in point. It is also supported by *United States* v. *Metropolitan Life Insurance Co.*, 256 F. 2d 17 (C.A. 4th), and *Kyle* v. *McGuirk*, 82 F. 2d 212 (C.A. 3d), and is in accord with *Freeman* v. *Mayer*, 253 F. 2d 295 (C.A. 3d), and *Givan* v. *Cripe*, 187 F. 2d 225 (C.A. 7th).

In the *Eiland* case, *supra*, the facts were in material respect substantially the same as here. There, a District Director of Internal Revenue levied upon an indebtedness owing to a taxpayer-bankrupt three days prior to the institution of bankruptcy proceedings. The debtor accepted service of the notice of levy and demand. After the adjudication of bankruptcy, it paid the sum levied upon to the trustee in bankruptcy pursuant to an order of the Referee. As in the instant case, the

United States claimed a lien on the property right for satisfaction of the taxes for which its levy and demand were made. Pointing out that a lien for taxes can be asserted against intangible property such as a debt, and that the proper way to assert the lien is by notice and levy, the Fourth Circuit held that, by levying upon the account receivable prior to the bankruptcy of the taxpayer, the Government thereby took possession of the indebtedness, so that the Government's lien claim was not postponed to the administration and wages claims for which priority was asserted under Section 67c of the Bankruptcy Act.[1] In its opinion, the Fourth Circuit stated that the effect of the levy was to transfer the creditor's right to receive payment to the United States. In this regard, it pointed out (p. 121) that when, as in the instant case, bankruptcy occurs *after* the levy and notice have been served upon a debtor of the bankrupt, the trustee in bankruptcy cannot interfere with the rights of the United States thereby perfected before bankruptcy.

Although the other cases cited above did not involve bankruptcy proceedings, they do, in legal effect, stand for the proposition that levy upon an indebtedness owed a taxpayer by a third party amounts to a seizure by the United States of the taxpayer's property rights in that debt.[2] Thus, in the *Metropolitan* and *McGuirk* cases, *supra*, it was held that an insured's interest in life insurance policies was subjected to tax liens of the

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[1] C. 541, 30 Stat. 544, 564 (11 U.S.C. 1952 ed., Sec. 107c).

[2] In *United States* v. *Liverpool & London Ins. Co.*, 348 U.S. 215, where it was held that tax liens of the United States were superior to the lien of a garnishee, notice of the tax lien with warrants of distraint and notice of levy had been served upon a debtor of its insurance company.

United States by levy effected pursuant to the provisions of the Internal Revenue Code.[3]

The holdings in *Freeman* v. *Mayer, supra*, and *Givan* v. *Cripe, supra*, are in complete and full accord with the *Eiland* holding (*supra*) and the decision below. The principle of those cases is that a levy is not effected by mere service of notice upon the debtor, nor in the absence of steps sufficient to appropriate the indebtedness levied upon and to establish the tax lien as one accompanied by possession. As the court below pointed out (Pet. 36), however, there is no suggestion in the instant case that the notice to and demand upon the debtor, Cherry Valley Homes, Inc., was in any way inadequate as a levy upon a debt it owed the taxpayer, and consequently that "On the record we have a perfected levy upon specific incorporeal property of a taxpayer, namely, a liquidated sum owed Tobin by Cherry Valley". Since that levy was perfected prior to the insolvency of the taxpayer's debtor, the previously existing tax lien of the United States was thereby transformed into a lien accompanied by possession of the indebtedness levied upon, which, as the court below held, was "clearly sufficient to establish a priority of right to satisfaction which the debtor's subsequent insolvency does not affect". In this posture of the case, no question of priorities under Section 3466 of the Revised Statutes is involved.

2. As an independent alternative basis for its decision, the court below held that the tax levy, through process served upon the debtor, at least accomplished an assignment of the taxpayer's claim against his debtor

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[3] The recent decision of this Court in *United States* v. *Bess*, 357 U.S. 51, does not affect this principle.

to the United States by operation of law which served to bring into effective operation the priority provisions of Section 3466 of the Revised Statutes.

This holding is supported by the decisions in *Wagner v. McDonald*, 96 F. 2d 273 (C.A. 8th), and *Korman v. Federal Housing Administrator*, 113 F. 2d 743 (C.A. D.C.). In those cases, the United States was an assignee prior to bankruptcy of a debt owed to a private creditor. In both cases, the courts rejected a contention, such as advanced here by the trustee (Pet. 13-16), that the rights of the United States did not extend beyond those of the taxpayer in the property assigned. Those courts pointed out that priority under Section 3466 did not depend upon how the United States acquired title to the property assigned, nor upon the status of the parties or the character of the obligation prior to the assignment. Rather, as pointed out in the *Wagner* case, *supra*, p. 275, "Priority is the result of insolvency of the debtor and ownership of the claim by the United States." See also *Beaston v. Farmers' Bank*, 12 Pet. 102, 134.

The cases[4] cited by the trustee (Pet. 14-16) in support of his contention that the taxpayer was merely a general creditor of Cherry Valley Homes, Inc., and, hence, that the United States could not acquire any greater rights than taxpayer had in the property levied upon, do not affect the holdings here. Those cases were merely concerned with whether or not the debtor against whom the tax lien of the United States was sought to

[4] *United States v. Winnett*, 165 F. 2d 149 (C.A. 9th); *Karno-Smith Co. v. Maloney*, 112 F. 2d 690 (C.A. 3d); *F. H. McGraw & Co. v. Sherman Plastering Co.*, 60 F. Supp. 504 (Conn.), affirmed, 149 F. 2d 301 (C.A. 2d), certiorari denied, 326 U.S. 753; and *Bankers Title and Abstract Co. v. Ferber Co.*, 15 N.J. 433.

be enforced had any property or property rights belonging to the tax delinquent creditor, and, if so, the amount thereof subject to the lien or levy. No such problems are presented herein for the facts show that the bankrupt was clearly indebted to the taxpayer in a liquidated amount prior to the inception of reorganization proceedings under Chapter X of the Bankruptcy Act. It is clear, moreover, that such indebtedness constituted "property or rights to property" subject to levy and distraint within the meaning of Sections 6331 and 6332 of the Internal Revenue Code of 1954 (Appendix, *infra*, pp. 10-11).[5]

3. The trustee's further contentions (Pet. 12-13, 17-18) that the decision below "violates public policy" and will have "widespread harmful effects on the interests of both the Federal Government and citizens" are also without merit for the reasons stated above. These contentions seem to be based upon the trustee's assertions (Pet. 12, 18) that there is no evidence of record that the taxpayer (Tobin) was insolvent and consequently that it would be "unfair and inequitable" for the United States to collect the amount due it from the taxpayer at the expense of the general creditors of the bankrupt without first exhausting the possibility of collecting its taxes from other assets of the taxpayer. However, as the court below pointed out (Pet. 37), there is no inequity in recognizing that the Government acquired a priority over general creditors when its claim was asserted and perfected against the debt owed by the bank-

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[5] See *United States* v. *Eland*, *supra*; *United States* v. *Metropolitan Life Insurance Co.*, *supra*; *United States* v. *Long Island Drug Co.*, 115 F. 2d 983 (C.A. 2d), and see also *Glass City Bank* v. *United States*, 326 U.S. 265; *Citizens State Bank of Barstow, Tex.* v. *Vidal*, 114 F. 2d 380, 382-383 (C.A. 10th); *Martens* v. *United States*, 245 F. 2d 135, 137 (C.A. 10th).

rupt many months before Chapter X proceedings were instituted. It added (Pet. 37) that to make the argument of inequity even colorable it would have to appear that the bankrupt (Cherry Valley Homes, Inc.) was insolvent when the levy was made upon the debt it owed, but that the record discloses no such fact.

## CONCLUSION

For the reasons stated, it is respectfully submitted that the petition for a writ of certiorari should be denied.

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SEPTEMBER 1958.

APPENDIX

Internal Revenue Code of 1954:

SEC. 6331. LEVY AND DISTRAINT.

(a) *Authority of Secretary or Delegate.*—If any person liable to pay any tax neglects or refuses to pay the same within 10 days after notice and demand, it shall be lawful for the Secretary or his delegate to collect such tax (and such further sum as shall be sufficient to cover the expenses of the levy) by levy upon all property and rights to property (except such property as is exempt under section 6334) belonging to such person or on which there is a lien provided in this chapter for the payment of such tax. Levy may be made upon the accrued salary or wages of any officer, employee, or elected official, of the United States, the District of Columbia, or any agency or instrumentality of the United States or the District of Columbia, by serving a notice of levy on the employer (as defined in section 3401(d) of such officer, employee, or elected official. If the Secretary or his delegate makes a finding that the collection of such tax is in jeopardy, notice and demand for immediate payment of such tax may be made by the Secretary or his delegate and, upon failure or refusal to pay such tax, collection thereof by levy shall be lawful without regard to the 10-day period provided in this section.

(b) *Seizure and Sale of Property.*—The term "levy" as used in this title includes the power of distraint and seizure by any means. In any case in which the Secretary or his delegate may levy upon property or rights to property, he may seize and sell such prop-

erty or rights to property (whether real or personal, tangible or intangible).

* * * * *

(26 U.S.C. 1952 ed., Supp. V, Sec. 6331.)

SEC. 6332. SURRENDER OF PROPERTY SUBJECT TO LEVY.

(a) *Requirement.*—Any person in possession (or obligated with respect to) property or rights to property subject to levy upon which a levy has been made shall, upon demand of the Secretary or his delegate, surrender such property or rights (or discharge such obligation) to the Secretary or his delegate, except such part of the property or rights as is, at the time of such demand, subject to an attachment or execution under any judicial process.

(b) *Penalty for Violation.*—Any person who fails or refuses to surrender as required by subsection (a) any property or rights to property, subject to levy, upon demand by the Secretary or his delegate, shall be liable in his own person and estate to the United States in a sum equal to the value of the property or rights not so surrendered, but not exceeding the amount of the taxes for the collection of which such levy has been made, together with costs and interest on such sum at the rate of 6 percent per annum from the date of such levy.

* * * * *

(26 U.S.C. 1952 ed., Supp. V, Sec. 6332.)

Revised Statutes:

Sec. 3466. Whenever any person indebted to the United States is insolvent, or whenever the estate of any deceased debtor, in the hands of the executors or administrators, is insufficient to pay all the debts due

from the deceased, the debts due to the United States shall be first satisfied; and the priority hereby established shall extend as well to cases in which a debtor not having sufficient property to pay all his debts, makes a voluntary assignment thereof, or in which the estate and effects of an absconding, concealed, or absent debtor are attached by process of law, as to cases in which an act of bankruptcy is committed.

(31 U.S.C. 1952 ed., Sec. 191.)

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